

2. Exceptions to the general rule regarding interest on loans from controlled sources of funds are made in the following circumstances. Interest on loans to those facilities classified as Intermediate Care facilities prior to October 1, 1990, by partners, stockholders or related organizations made prior to July 1, 1975 shall be allowable as cost, as determined under these principles, provided that the terms and conditions of payment of such loans have been maintained in effect without modification subsequent to July 1, 1975. For facilities classified as Skilled facilities prior to October 1, 1990, the same policy applies for this type loan made prior to and maintained without modification subsequent to December 1, 1979. Where the general fund of a provider "borrows" from a donor-restricted fund and pays interest to the restricted fund, this interest expense is an allowable cost. The same treatment shall be accorded interest paid by the general fund on money "borrowed" from the funded depreciation account of the provider or from the provider's qualified pension fund. In addition, if a facility operated by members of a religious order borrows from the order, interest paid to the order shall be an allowable cost.

3. Where funded depreciation is used for purposes other than improvements, replacement, or expansion of facilities or equipment related to patient care, allowable interest expense shall be reduced to adjust for offsets not made in prior years for earnings on funded depreciation. A similar treatment shall be accorded deposits in the provider's qualified pension fund where such deposits are used for other than the purpose for which the fund was established.

If a facility is sold and the funded depreciation account is not transferred to the purchaser, the earnings of the funded depreciation account shall be treated as an investment income. Any investment income that had been earned by the funded depreciation account and had not been utilized to reduce interest expense, shall be considered an overpayment by the Program and a retroactive cost settlement shall be computed at the time of the sale. If the funded depreciation account is transferred to the purchaser and the purchaser eliminates the account, any investment income earned in prior years by the account shall be offset against interest expense of the purchaser.

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D. INTEREST NOT REASONABLY RELATED TO PATIENT CARE

Interest expense is not reasonably related to patient care if:

1. It is paid on borrowings in excess of the allowable basis of the asset.
2. It is made to defer principle payments.
3. It is used to purchase goodshall or other intangible asset.
4. It is in the form of penalty payments.

E. INTEREST EXPENSE ON PURCHASES OF FACILITIES ON OR AFTER JULY 18, 1984. For facilities purchased on or after July 18, 1984, the amount of interest expense allowed to the purchaser shall be limited to the amount that was allowable to the seller at the time of the sale.

353. FACILITY LEASE/RENT ARRANGEMENTS

- A. For nursing facilities previously classified as intermediate care facilities, the allowable cost of all lease/rent arrangements occurring after 4/20/76 shall be limited to the owner's allowable historical costs of ownership. The effective date of this limitation for nursing facilities previously classified as Skilled Nursing facilities is 12/1/79. Such historical costs of ownership can include the owner's interest expense, depreciation expense, and other costs such as taxes, insurance, maintenance, etc. In the event of the sale/leaseback arrangement, only the original owner's allowable basis shall be recognized.

The owner's allowable historical cost shall be subject to the basis limitations as applied to property owned by providers. Additionally, allowable depreciation and interest shall not exceed that which would have been allowed had the assets been owned by the provider.

In order to have the allowable cost determined and approved, all data pertaining to the lease/rent arrangement, including the name of previous owners, shall be submitted by the provider.

In regard to lease/rent arrangements occurring prior to 4/20/76 for basic IC and 12/1/79 for Skilled Nursing, the Program shall determine the allowable costs of such arrangements based on the general reasonableness of such costs.

- B. Lease/Rent arrangements for land only shall be considered an allowable cost if the lease agreement does not contain an option to purchase at less than market value. If the lease amount is a set amount each year, such lease amount should be reclassified to the Depreciation Expense cost center. If the lease amount varies from one year to the next, the lease amount shall be reclassified to the Operation and Maintenance of Plant cost center.

354. CAPITAL LEASES

Leases determined to be Capital Leases under Generally Accepted Accounting Principles (GAAP) shall be accounted for under the provisions of GAAP. However, all basis limitations applicable to the depreciation and interest expense of purchased assets shall apply to Capital Leases.

355. AMORTIZATION OF ORGANIZATION AND START-UP COSTS

Organization and start-up costs as defined in Health Insurance Manual 15 shall be amortized in accordance with the provisions of Health Insurance Manual 15.

356. ACCELERATED DEPRECIATION TO ENCOURAGE REFINANCING

To encourage facilities to refinance loans for long term debt in existence on December 1, 1992 at lower interest rates and for shorter durations than their current financing, the Kentucky Medicaid Program shall allow an increase in depreciation expense equal to the increased principal payments (principal payments on the allowable portion of the loan under the new financing minus the principal payments under the old financing on the allowable portion of the loan). However, this increase in allowable depreciation expense shall not exceed the reduction in allowable interest expense which results from the refinancing. Interest savings for any period shall be computed as follows: allowable interest expense which would have been incurred under the previous loan, plus allowable amortization of financing costs which would have been incurred under the previous financing arrangement, minus allowable interest expense under the new financing arrangement, minus allowable amortization of loan costs under the new loan (including any unamortized loan expense from the previous loan). Total depreciation allowed (including the additional depreciation) shall reduce the allowable depreciable basis of the building. Total



depreciation expense allowed over the lives of the assets that make up the facility shall not exceed the allowable undepreciated basis of the building. The additional depreciation allowed by this provision shall first be applied against the allowable basis of the longest lived asset which has any remaining allowable undepreciated basis. The remaining allowable undepreciated basis of the facility at the end of the refinanced loan, shall be depreciated over the remaining useful lives of the assets utilizing straight line depreciation.

If subsequent to the refinancing and claiming of accelerated depreciation, the facility is sold (either the operating entity holding the nursing facility licensure or the building on which the accelerated depreciation is claimed) or the facility voluntarily discontinues participation in the Medicaid Program, the following recapture provisions shall be applied:

1. The owner who claimed the accelerated depreciation shall pay the Medicaid Program an amount equal to the difference in depreciation claimed for the certified nursing facility with and without the accelerated depreciation, times the average Medicaid percentage of total occupancy in the certified nursing facility.

2. If the facility remains in the Medicaid Program, the allowable depreciable basis for the new owner shall be the allowable depreciable basis had the prior owner never utilized accelerated depreciation for Medicaid reimbursement.